Supreme Court, U.S.
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No.

IN THE

Supreme Court of the United States

IN RE:

UNITED MERCHANTS AND MANUFACTURERS, INC., and VICTORIA CREATIONS, INC.,

Debtors.

FRANKLIN FELDMAN,

Petitioner,

against

SKADDEN, ARPS, SLATE, MEAGHER & FLOM LLP, MICHAEL L. COOK, GEORGE A. ZIMMERMAN, KENNETH J. BIALKIN, AND UZI RUSKIN,

Respondents.

ON PETITION FOR WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

PETITION FOR WRIT OF CERTIORARI

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QUESTIONS PRESENTED FOR REVIEW

May a court allow a law firm to receive the major portion of its requested legal fee for representing a debtor corporation in the United States Bankruptcy Court when that law firm has failed to disclose serious conflicts of interest, which disclosure is required by the relevant sections of the Bankruptcy Code?

May a court deny reasonable compensation to attorneys who have made a "significant contribution" to the Bankruptcy proceeding as such is defined by the Bankruptcy Code?

PARTIES TO THE PROCEEDING

The parties to this action in the United States Court of Appeals for the Second Circuit were Franklin Feldman; Skadden, Arps, Slate, Meagher & Flom LLP; Michael L. Cook, Kenneth J. Bialkin, George A. Zimmerman; and Uzi Ruskin.

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PETITION FOR WRIT OF CERTIORARI

Petitioner, Franklin Feldman, respectfully prays that a writ of certiorari issue to review the judgment and opinion of the United States Court of Appeals for the Second Circuit entered in the above-entitled proceeding on November 30, 1999.

OPINIONS AND ORDERS BELOW

This petition is from an initial decision of the United States Court of Appeals for the Second Circuit dated September 22, 1999 and is reproduced as Appendix A (App.), at App. 1. On November 30, 1999, the United States Court of Appeals for the Second Circuit denied Petitioner's Petition for Rehearing en banc, reproduced as App. B, at App. 10. The Court of Appeals had affirmed the opinion of District Judge Denny Chin dated January 5, 1999, reproduced as App. C, at App. 12. Judge Chin had affirmed the decision of Bankruptcy Judge Arthur G. Gonzalez dated June 10, 19967 reproduced as App. D, at App. 18.

JURISDICTION

The decision of the United States Court of Appeals denying

petitioner's petition for rehearing en banc was dated November 30, 1999. This petition for writ of certiorari has been timely filed in accordance with Rule 13.3 of the Rules of this Court. This Court has jurisdiction over this matter pursuant to 28 U.S.C. § 1257 (a).

FEDERAL QUESTIONS AT ISSUE

There is a conflict in the decisions of the Circuit Courts of Appeals as to whether the Bankruptcy Code requires the forfeiture of all or the substantial part of a law firm's requested legal fee when it has intentionally failed to disclose conflicts it has in representing a Debtor in a bankruptcy proceeding.

There is no significant authority as to the circumstances or criteria applicable to the award of compensation to attorneys who have made a "significant contribution" in a Bankruptcy proceeding.

Article I, Section 8 of the United States Constitution requires that there be "uniform Laws on the subject of Bankruptcies throughout the United States."

INTRODUCTION

The appeal to the United States Court of Appeals arose from the affirmance by District Judge Denny Chin of an order of Bankruptcy Judge Arthur J. Gonzalez denying Petitioner's application for appropriate sanctions against the

law firm of Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden") three of its partners (Michael L. Cook ("Cook"), Kenneth J. Bialkin ("Bialkin"), and George A. Zimmerman, and Uzi Ruskin ("Ruskin"), the President and Chief Executive Officer of United Merchants and Manufacturers, Inc. ("United Merchants" or "UM&M") which filed its third Chapter 11 proceeding in February 1996. (the second under Ruskin).

Sanctions were sought against Skadden for (1) the conflict which it had in connection with Petitioner's application for a trustee pursuant to Bankruptcy Code §1104, (2) its failure to disclose the "connections" and conflict it had in representing the debtor United Merchants pursuant to Bankruptcy Rule 2014 (a), (3) its improper use of the Southern District as a venue for the instant bankruptcy filing pursuant to Bankruptcy Code §1408 (28 U.S.C. §1408), (4) its failure to disclose that a Chapter 11 proceeding was then pending in Delaware, and (5) for harassment of Petitioner, a member of the New York Bar. Sanctions were claimed against Ruskin for filing the Chapter 11 Petition in bad faith and causing false and fraudulent documents to be filed in this proceeding.

On September 22, 1999 the Court of Appeals for the Second Circuit entered a Summary Order affirming the decision of Judge Chin. On November 30, 1999 the Second Circuit denied Petitioner's request for a rehearing en banc.

REASONS FOR GRANTING THE WRIT

It is submitted that a writ should be granted because the decision of the Court of Appeals for the Second Circuit (1) conflicts with decisions of other Circuits which have dealt with similar questions of conflict; and (2) presents important questions of federal law with respect to the administration and integrity of the Bankruptcy system of the United States.

ARGUMENT

1. **There Was a Major Conflict by Skadden and its Partners**

The September 22, 1999 Memorandum Decision of the Court of Appeals for the Second Circuit stated that the Bankruptcy Court "granted the motion as to Skadden's conflict." That is inaccurate. Bankruptcy Judge Gonzalez did not grant the motion as to Skadden's conflict. He reduced Skadden's legal fee by $225,000 only for the late disclosure of Bialkin's stock ownership. (See App. D, at App.18.)

There was a major conflict on Skadden's part in opposing Feldman's motion for a Trustee and the removal of Ruskin, as chief executive officer. Bialkin, a senior partner of Skadden had previously (when he was a senior partner at Willkie Farr & Gallagher) represented Ruskin when

Ruskin sought control of United Merchants in 1980 (see Petitioner's Appendix submitted to Court of Appeals at A168, herein "Petit. App. CCA"). Skadden represented Ruskin again in 1989 and 1990 when Ruskin sought to reorganize the company so that he would have majority control. (See Petit. App CCA at A123). This conflict had serious consequences. Ruskin had personally guaranteed a $4 million obligation to United Merchants which was made by a sham corporation owned exclusively by him. At the time of the instant bankruptcy filing and Feldman's motion to remove Ruskin as Chief Executive Officer, the obligation had increased to $6 million (which included $2 million of interest).

The senior associate at Skadden who had the principal responsibility of preparing the papers in this proceeding (Lawrence V. Gelber acknowledged in court that "Mr. Ruskin's position may have been adverse to the position of the corporation". (See Petit. App CCA, A239, at p. 116).

It is respectfully submitted that where a law firm and one of its senior partners has represented the chief executive officer of a corporation who is sought to be removed, there is a most serious conflict. In fact, the New York Court of Appeals in a most recent ruling on July 1, 1999 held that an entire law firm must be disqualified when a young associate (not a partner) moves from one law firm to another and works on a related matter. See Kassis v. Teacher's Insurance and Annuity Association (1999 N.Y. LEXIS 1430). Here, it was a senior partner—not a junior associate—who had represented

the adverse party in a thoroughly related matter. Thus, contrary to the Order of the Second Circuit, we submit that there was a "breach of [a] fiduciary duty."

2. Cook Knew of the Conflict Prior to the Hearing Before Judge Gonzalez and Did Not Disclose It

Cook, the senior bankruptcy partner at Skadden, knew of the prior representation and stock ownership approximately two weeks before Judge Gonzalez was to hear Feldman's motion, but did not notify the Court until three days after the decision. Lawrence V. Gelber, the senior associate at Skadden, testified in Court that he had informed Cook of the information contained in Bialkin's belated disclosure form[1] during the week of May 6, 1996---approximately two weeks before the hearing on May 17, 1996. (See Petit. App. CCA at A239). Cook did not inform the Court until May 20, 1996. *(Id* at A115).

3. The Southern District Was Not a Proper Venue For the Filing of the Instant Chapter 11 Proceeding-and Cook and Skadden Knew It

Under 28 U.S.C. §1408 the proper venue for the commencement of a Chapter 11 proceeding was either the

[1] Gelber testified that Bialkin's disclosure form was lost or "misplaced"and no copy existed. He testified: "I believe I had the only copy of it and I can no longer locate that copy." Cook testified that he never saw the Bialkin disclosure form.

domicile of the entity, where its principal place of business or assets are located, or where a proceeding was pending. United Merchants was a Delaware corporation and had no office or business in New York. Victoria Creations, Inc. (Victoria), the 79% subsidiary of United Merchants, was a Rhode Island corporation and its principal office and assets were located in Rhode Island. Skadden and Cook knew that to be the case. A Chapter 11 proceeding instituted by United Merchants was then "pending" in Delaware and Cook and Skadden knew that. Skadden's argument below that jurisdiction was based on the fact that a petition on behalf of Victoria was filed a few minutes before the United Merchants filing lacks any merit. So does its argument that the "nerve center" of Victoria was in New York. To knowingly claim an improper jurisdictional basis is a fraud on the Court and should be sanctioned. Feldman never waived this point. He raised it when he first became aware of the facts---and indeed the jurisdictional point could not have been waived.

4. There Was a Pending Chapter 11 Proceeding in Delaware and Cook and Skadden Did Not Disclose It When Filing in New York

The petition did not disclose that there was a Chapter 11 proceeding "pending" in Delaware when the New York petition was filed. Cook knew this to be so inasmuch he and Skadden were co-counsel in the Delaware proceeding and Cook signed significant papers in that proceeding.

5. The Testimony of, and Papers Filed by, Ruskin, Cook, and Bialkin Were Clearly False and Under Sections 151, 152 and 3057 of the United States Criminal Code Required the Court to Refer the Matter to a United States Attorney

The conduct of Ruskin, Cook and Bialkin was so egregious in these proceedings as to require that a judge "having reasonable grounds for believing that any violation...relating to insolvent debtors...has been committed...shall report to the appropriate United States attorney all the facts and circumstances of the case..." See 18 U.S.C. § 3057. This was not done.

As for Ruskin: Despite the fact that the independent certified financial statements of UM&M stated that he and his Netherlands Antilles wholly-owned corporation owed UM&M $6 million for the purchase of UM&M stock, Ruskin testified under oath that the transaction was created for his "tax purposes" and that the debt did not exist. He testified that he only had an "option" to acquire the stock---even though he voted it!

Ruskin further testified that UM&M would earn more than $25 million in its first year of operation after confirmation of his Plan in a business in which it had no experience . In fact, UM&M has not produced one penny of revenue---let alone profit---from that business or any other business since Ruskin's testimony in court.

As for Cook: He knew that Bialkin and Skadden had previously represented Ruskin when Ruskin sought control of UM&M, but did not reveal that information until after the Court rendered its decision on Petitioner's motion for a trustee.

Cook knew that at the time of filing the Chapter 11 Petition in New York in February 1996, a Chapter 11 Petition was then "pending" in Delaware and he did not disclose that fact in the Petition (which he signed) or so advise the Court.

As for Bialkin: He knew that an affidavit submitted by him in the 1990 Delaware Chapter 11 proceeding of UM&M conflicted with his belated 1996 affidavit, but offered no explanation of the conflict, or any explanation why it took him and Skadden five months to submit five affidavits with respect to the matter.

6. The Court's Refusal to Disgorge All or Substantially All of the Fees of Skadden on Account of its Conflict is in Conflict with decisions in Other Circuits and in Other Courts Which Have Dealt With a Similar Question

Other Circuits have ruled differently and in stark contrast with the Order in this Court where in a bankruptcy proceeding a conflict on the part of lawyers has been involved.

See, for example:

In re Park-Helena Corp., 63 F. 3d 877 (9th Cir. 1995) ("The disclosure requirements of Rule 2014 are applied as strictly as the requirements of Rule 2016 and section 329...")

In re Crivello, 134 F. 3d 831, 839 (7th Cir. 1998) ("We believe a bankruptcy court should punish a willful failure to disclose the connections required by Fed. R. Bankr. 2014 as severely as an attempt to put forth a fraud on the courts.")

In re Prince, 40 F. 3d 356, 359 (11th Cir. 1994) ("Law firms, no matter their size, must ensure that their representations do not result in irreconcilable conflicts.")

In re Downs, 103 F. 3d 472 (6th Cir. 1996)

Halbert v. Yousif, 225 B.R. 336, 338 (E.D. Mich.. 1998) ("...a complete denial of compensation can be ordered even if disclosure violations innocently resulted from neglect, oversight, or lack of familiarity with bankruptcy requirements")

In re Bolton-Emerson, Inc., 200 B.R. 725 (D. Mass. 1996) ("court may deny all compensation to an attorney as a 'penalty' for failing to avoid a disqualifying conflict of interest")

In re Smitty's Truck Stop., Inc. 210 B.R. 851 (10th Cir. BAP 1997) and In re Cook, 223 B.R. 782, 784 (10th BAP 1998) ("Absent the spontaneous and complete disclosure required by §327 (a) and Rule 2014, court-approved counsel proceed at their own risk")

In re Marine Outlet, Inc., 135 B.R. 154 (Bankr. M.D. Fla. 1991) ("...a failure to comply with the mandate of Bankruptcy Rule 2014 (a) merits a total forfeiture of all fees.")

In re Bonneville Pacific Corp., 196 B.R. 868 (Bankr. D. Utah 1996) (attorney serving conflicting interest "must" be denied all compensation)

In re Leslie Fay Companies, 175 B.R. 525, 533 (Bankr. S.D.N.Y. 1994)

Woods v. City National Bank & Trust Co., 312 U.S, 262, 61 Sup. Ct. 493, 85 L. Ed. 820 (1940) ("Where a claimant, who represented members of the investing public, was serving more than one master or was subject to conflicting interests, he should be denied compensation.")

A particularly apt case is one in which Skadden and Cook were themselves involved where the Chief Bankruptcy Judge in Houston, Texas ruled that Skadden had been acting in the best interests of the principals of the debtor, although purporting to act for the debtor. In that case, the Court

disgorged more than $1,207.000 in legal fees and $226,000 in expenses from Skadden. (See In re Coral Petroleum (83-02460-H-2-5) (Bankr. Houston, Texas) (unpublished) (ten copies of the opinions of the Bankruptcy Court have been lodged with the Clerk of this Court).

Very relevant authorities are the recent decisions taken in the Chapter 11 proceedings involving the New York law firms of Willkie, Farr & Gallagher and Milbank, Tweed, Hadley & McCloy. In In re Granite Partners, L.P., 219 B.R. 22 (Bankr. S.D. N.Y. 1998), the Bankruptcy Court in the Southern District of New York sanctioned the Willkie Farr firm for its conflict and held that it was not entitled to $2,093,700.45 in fees, and a substantial part of its out-of-pocket expenses.

The Milbank Tweed case is more striking. There, in the Milwaukee Chapter 11 Bankruptcy of Bucyrus-Erie Co., the Milbank firm agreed to refund $1.86 million in fees in settlement of a claim that it had a conflicting relationship---and one of its partners was convicted in a criminal trial for misleading the bankruptcy court about the potential conflict!

7. Feldman Was Entitled to a Reasonable Fee for His Substantial Contribution in the Proceedings

The Order of the Court of Appeals states that the bankruptcy court was not clearly erroneous in finding that Feldman's efforts were "wasteful or duplicative." It is

respectfully submitted that this is not the case. No one, other than Feldman, joined in his petition to have Ruskin removed and a trustee appointed. The attorneys for the Unsecured Creditors Committee did not support Feldman's motion---indeed opposed it---and did not examine the charges made with respect to the Guaranty of Ruskin which he refused to perform, nor the more than $6 million obligation ($4 million plus interest) he owed.

In fact, the United States in a filing in the Bankruptcy Court expressly stated that the Supplemental Disclosure Affidavits of Cook and Bialkin were filed after, or in response to, allegations of Feldman (See Petit. App. CCA at A214).[2]

The September 22, 1999 Order of the Court of Appeals states that the Court has not yet had occasion to "articulate the contours of what is a 'substantial contribution' sufficient to render parties eligible for compensation under 11 U.S.C. §503 (b) (3) (D), but we have no need to do so today." We respectfully submit that this case provides an opportunity for the Supreme Court to provide such guidelines to the bar and thereby perform a particularly useful service to those professionals who render service on behalf of clients in bankruptcy proceedings. In this case, Feldman was responsible for the elimination of $225,000 from Skadden's

[2] With respect to the compensation requested by Petitioner, the amount referred to in Judge Chin's decision covered the services of Petitioner and two other lawyers who assisted him in the litigation. As disclosed in Skadden's Fee Application, his hourly rate was lower than the hourly rate charged by Cook and Bialkin in this proceeding.

fees; the elimination of a $500,000 annual employment contract with Ruskin; and bringing to the attention of the Court the serious conflict which Skadden and Bialkin had, as well as the improper filing in New York, all of which represented a substantial contribution. We believe that where a lawyer, essentially acting alone against the largest law firm in the United States, undertakes such efforts and brings to the Court's attention these significant matters, he merits reasonable compensation and this Court should provide some parameters to measure an award.

CONCLUSION

This is not a routine bankruptcy case in which the Court may have limited interest. This case deals with a conflict among the Circuit Courts of Appeals on a fundamental matter and raises important issues as to (a) the responsibility of lawyers in bankruptcy proceedings to disclose significant conflicts and (b) the obligation of Federal courts to deal with lawyers who fail to meet the standards required by applicable statutes and rules. Accordingly, based on the foregoing, a writ should be granted.

Respectfully submitted,

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Attorney for Petitioner

APPENDIX A

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

THIS SUMMARY ORDER WILL NOT BE PUBLISHED IN THE FEDERAL REPORTER AND MAY NOT BE CITED AS PRECEDENTIAL AUTHORITY TO THIS OR ANY OTHER COURT, BUT MAY BE CALLED TO THE ATTENTION OF THIS OR ANY OTHER COURT IN A SUBSEQUENT STAGE OF THIS CASE, IN A RELATED CASE, OR IN ANY CASE FOR PURPOSES OF COLLATERAL ESTOPPEL OR RES JUDICATA.

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 22th day of September, one thousand nine hundred ninety-nine.

PRESENT:
HON.ELLSWORTH VANGRAAFEILAND
HON. GUIDO CALABRESI
HON. ROBERT D. SACK,
Circuit Judges

In re UNITED MERCHANTS AND MANUFACTURERS, INC. and VICTORIA CREATIONS, INC,

Debtors

FRANKLIN FELDMAN,

Appellant,

v.

SKADDEN, ARPS, SLATE, MEAGHER & FLOM, LLP, MICHAEL L. COOK, GEORGE A. ZIMMERMAN, KENNETH J. BIALKIN, UZI RUSKIN, OFFICE OF THE UNITED STATES TRUSTEE, ZALKIN, RODIN & GOODMAN, LLP, AND REUNITED HOLDINGS, INC.

Appellees.

SUMMARY ORDER #99-5011

Appeal from the United States District Court for the Southern District of New York (Denny Chin, *Judge*)

UPON DUE CONSIDERATION, it is ORDERED, ADJUDGED, and DECREED that the judgment of the district court be and hereby is AFFIRMED.

For Appellant: STEPHEN H. GARRIN, I. WALTON BADER, Of Counsel, New York, N.Y.

For Appellees: MICHAEL L. COOK, SHMUEL VASSER,

Skadden, Arps, Slate, Meagher & Flom LLP, New York, N.Y. for appellees United Merchants and Manufacturers, Inc., Reunited Holdings, Inc., Skadden, Arps, Slate, Meagher &

Flom LLP, Michael L. Cook, George A Zimmerman & Kenneth J. Bialkin

STEPHEN D. HOFFMAN, Rosen & Reade, LLP, New York, N.Y. for appellee Uzi Ruskin

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Appellant Franklin Feldman appeals from the judgment of the United States District Court for the Southern District of New York (Chin, *Judge*), affirming the decision of the United States Bankruptcy Court for the Southern District of New York (Gonzalez, *Bankruptcy Judge*). On appeal, Feldman challenges the decision of the bankruptcy court to deny his motion for sanctions against appellee Ruskin and appellee Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden") and to reject his application for fees and costs. We affirm.

I.

On February 22, 1996, Victoria Creations, Inc. ("VCI") and its parent corporation United Merchants and Manufacturers, Inc. ("UM&M") (collectively, "the Debtors") each filed a Chapter 11 petition for bankruptcy in the Southern District of New York.

In April 1996, appellant Franklin Feldman, ashareholder and former attorney for UM&M, filed a motion seeking appointment of a trustee on the grounds that UM&M had a potential claim against its chief executive, appellee Uzi Ruskin. After a hearing on May 17, 1996, the bankruptcy court denied Feldman's motion.

The Debtors filed proposed reorganization plans in January 1997, and the bankruptcy court scheduled a confirmation hearing for April 9, 1997. In March 1997, Feldman renewed his motion seeking appointment of a trustee. He again alleged that Ruskin had various interests adverse to debtor UM&M. And he also asserted that Skadden, counsel to the debtor, had belatedly disclosed a conflict. Specifically, he contended that one of its partners, appellee Kenneth J. Bialkin, owned stock in UM&M and had, while at another firm, previously represented Ruskin---a party who, in Feldman's view, had an interest adverse to UM&M. The bankruptcy court treated the motion as an objection to the confirmation of the plans.

While this motion was pending, Feldman filed a request for compensation under 11 U.S.C. § 503 (b) (3) (D), (4) (1994 & Supp. 1999 (authorizing compensation for specified parties who have made "substantial contribution[s] to a Chapter 11 proceeding). He sought a total of $350,810 in fees and expenses.

After a full hearing and before ruling on Feldman's

objections and approved the reorganization plans. Feldman did not appeal this decision.

Thereafter, Feldman moved for sanctions against Skadden, three of its partners, and Ruskin.
The grounds for the sanctions motion were that the parties against whom Feldman sought sanctions had allegedly (1) harassed Feldman by threatening him with sanctions in retaliation for his effort to seek compensation from the estate and serving him with a subpoena, (2) knowingly filed the debtors' petition in the Southern District of New York, where venue was improper, and (3) failed to disclose Skadden's conflicts. In his motion. he also emphasized Skadden's putative conflicts, arising from its prior representation and from Bialkin's ownership, during a specified period, of stock in debtor UM&M.

On June 10, 1997, the bankruptcy court denied the sanctions motion as to the harassment and the filing in the Southern District of New York, but granted the motion as to Skadden's conflict. It found that Skadden's alleged threat to seek sanctions was an acceptable basis for questioning the legal basis of Feldman's application for compensation. And it concluded that the subpoena was a procedurally appropriate device to secure appellant's testimony. Because it held that venue was proper, and that Feldman had, in any event, waived any objection to venue, it denied the motion for sanctions based on the filing in that district.

The bankruptcy court did, however, find that Bialkin's ownership of some stock in UM&M during a discrete period disqualified Skadden from serving, during that time, as counsel to the debtor under 11 U.S.C. §327 (a) (1994) (authorizing employment of professionals on behalf of the estate only if they "do not hold or represent an interest adverse to the estate, and...are disinterested persons"). Accordingly, it reduced Skadden's fee award by $225,000. The other potential conflicts raised by Feldman did not, in the court's view, result in an 'adverse interest' that would warrant [Skadden's complete] disqualification.

At the same time, the bankruptcy court rejected Feldman's application for compensation, concluding that appellant had not made substantial contributions to the proceedings and that his activities were instead either wasteful of estate resources or duplicative of efforts by the creditor's committee or the United States States Trustee.

Feldman appealed to the district court, challenging, *inter alia*, the bankruptcy court's decision to deny appellant's application for compensation, to reject his motion for sanctions, and to award some fees to Skadden. The district court affirmed the bankruptcy court. Feldman moved for reconsideration and the court below denied the motion.

On appeal, Feldman argues that the bankruptcy court abused its discretion in denying the motion for sanctions and the application for compensation.

II.

The district court's order affirming the bankruptcy court is "subject to plenary review." *Shugrue v. Air Pilots Ass'n, Int'l (In re Ionosphere Clubs, Inc)*, 922 F. 2d 984, 988 (2d Cir. 1990). This court "review[s] conclusions of law *de novo*, and findings of fact under a clearly erroneous standard." *Id.* We review for an abuse of discretion both the decisions of the bankruptcy court regarding sanctions, see *Baker v. Latham Sparrowbush Assoc. (In re Cohoes Indus. Terminal, Inc)*, 931 F. 2d 222, 227 (2d Cir. 1991), and its awards of compensation, *see In re Arlan's Dep't Stores, Inc.*, 615 F. 2d 925, 943 (2d Cir. 1979).

The bankruptcy court declined to impose sanctions on the basis either of the alleged harassment or of the claimed improper filing in the Southern District. The bankruptcy court expressly found legitimate explanations for the conduct that Feldman deemed harassment and it also correctly determined that venue was proper in the Southern District. Accordingly, appellant's challenge to these rulings is without merit.

The bankruptcy court did, however, sanction Skadden in the amount of $225,000 for the belated disclosure of Bialkin's ownership of stock in UM&M. It did not, to Feldman's dismay, deny all fees to Skadden or impose sanctions for the firm's other potential conflicts. Although the bankruptcy code requires that professionals retained for the estate be "disinterested," *see* 11 U.S.C. §327 (a), it also

acknowledges that compensation who are *not* disinterested may be appropriate in some circumstances. This is evidenced in the permissive language of 11 U.S.C. §328 (c), which provides that "the court *may* deny [fees and costs]...if, at any time...such professional person is not a disinterested person." Id. (emphasis added). "There is no doubt of the inherent power of a bankruptcy judge to deny fees and disbursements where serious breaches of fiduciary obligations occur." I*n re Arlan's Dep't Stores, Inc.*, 615 F. 2d at 943. But where, as here, (a) there was no finding of a breach of any fiduciary duty and (b) the actual sanction imposed reduced Skadden's total fees by 16% and its fees for the period prior to the late disclosure by 50% from the amount sought in its fee application, we cannot say that the bankruptcy court abused its discretion in declining to deny all compensation.

We likewise cannot say that the bankruptcy court erred in refusing to award Feldman compensation. We have not yet had occasion to articulate the contours of what is a "substantial contribution" sufficient to render parties eligible for compensation under 11 U.S.C. §503 (b) (3) (D), but we have no need to do so today. The bankruptcy court was not clearly erroneous in finding that the activities for which Feldman sought compensation were either wasteful or duplicative. Activities that retard and interrupt cannot be said to have substantially contributed to a Chapter 11 proceeding.

III.

Having reviewed all of plaintiff's claims and having found them to be without merit, we AFFIRM the judgment of the district court granting summary judgment for defendants.

For the Court,
KAREN GREVE MILTON
ACTING CLERK

BY:
/s/ RALPH A. ANDERSON, Deputy Clerk
ACTING OPERATIONS MANAGER

APPENDIX B

UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT

At a stated term of the United States Court of Appeals for the Second Circuit, held at the United States Courthouse, Foley Square, in the City of New York, on the 30 day of November one thousand nine hundred and ninety-nine

In re: UNITED MERCHANTS AND MANUFACTURERS,INC. and VICTORIA CREATIONS, INC.
Debtors.

Dkt. No-99-5011

A petition for panel rehearing and a petition for rehearing en banc having been filed herein by the appellant Frank [sic] Feldman.

Upon consideration by the panel that decided the appeal, it is Ordered that said petition for rehearing is DENIED,

It is further noted that the petition for rehearing en banc has been transmitted to the judges for the court in regular active service and to any other judge that heard the appeal and that no such judge has requested that a vote be taken thereon.

FOR THE COURT

KAREN GREVE MILTON, Acting Clerk

BY: /s/Beth J. Meador, Administrative Attorney

APPENDIX C

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

In re
UNITED MERCHANTS AND MANUFACTURERS, INC. and VICTORIA CREATIONS, INC.,

---

FRANKLIN FELDMAN

Appellant,

-against-

UNITED MERCHANTS AND MANUFACTURERS, INC., et al.

Appellees.

MEMORANDUM DECISION
97 Civ. 5437 (DC)

CHIN, D.J.

In this bankruptcy case, appellant Franklin Feldman appeals from two orders of the United States Bankruptcy Court for the Southern District of New York (Arthur J. Gonzalez, Bankruptcy Judge) entered on June 19, 1997. Feldman, an attorney and a shareholder of the debtor United Merchants and Manufacturers, Inc. ("UM&M"), participated in the bankruptcy proceedings below.

Feldman challenges four aspects of the Bankruptcy

Court's rulings on this appeal: (1) its award of fees to Skadden, Arps, Slate, Meagher & Flom LLP ("Skadden"), counsel for UM&M and debtor Victoria Creations, Inc. ("Victoria"); (2) its award of fees to Zalkin, Rodin & Goodman LLP ("ZR&G"), counsel for the Committee of Unsecured Creditors; (3) its denial of an application by Feldman (and two colleagues) for a "substantial contribution" award of fees and costs; and (4) its denial of Feldman's application for sanctions against Skadden, three of its partners, and Uzi Ruskin (the chief executive officer of the debtors).

The Bankruptcy Court's findings of fact are subject to a clearly erroneous standard of review its legal conclusions are reviewed de novo; and its decisions to award or deny fees and sanctions are subject to an abuse of discretion standard. See Momentum Mfg. Corp. v. Employee Creditors Comm. (In re Momentum Mfg. Corp.), 25 F. 3d 1132, 1136 (2d Cir. 1994) ("The bankruptcy court's legal conclusions are evaluated de novo; its findings of fact are subject to a clearly erroneous standard.") Cooter & Gell v. Hartmarz Corp., 496 384, 405 (1990) (Rule 11 sanctions subject to abuse of discretion standard of review); Zeisler & Zeisler v. Prudential Ins. Co. (In re JLM, Inc.), 210 B.R. 19, 23 (B.A.P. 2d Cir. 1997) (fee award subject to abuse of discretion standard of review).

1. Skadden's Fee Award

Skadden filed three fee applications in the Bankruptcy Court. The Bankruptcy Court reduced the firm's fee by

$225,000 which was approximately 16% of the total fees sought. The Bankruptcy Court did so after conducting an evidentiary hearing (in which Feldman participated) on the U.S. Trustee's objection to the firm's first interim fee application. The U.S. Trustee had asked the Bankruptcy Court to consider two issues: (a) the ownership by a Skadden partner (Kenneth J. Bialkin) of some 37,000 shares of UM&M stock, and (b) Bialkin's representation, while a partner at a different law [sic], of Ruskin some 16 years earlier. These matters were disclosed by Skadden, but some three months after they should have been. In addition, Skadden had represented Ruskin on unrelated matters in 1989, at a time when Skadden was not representing UM&M or Victoria.

After the hearing, the Bankruptcy Court reduced Skadden's fees by $225,000 because of the late disclosure. The U.S. Trustee---who had lodged the initial objection---did not appeal.

The Bankruptcy Court did not abuse its discretion in awarding fees to Skadden with a $225,000 reduction for the late disclosure. While there can be no dispute that Skadden should have made the disclosure earlier, no party ever moved to disqualify Skadden as counsel for the debtors, even after the disclosure was made. Skadden continued to represent the debtors for more than a year after the disclosure.Moreover, the potential conflicts were not significant ones. The 37,000 shares represented less than 1% of UM&M's stock and had

little, if any, value; they were eventually donated to charity. Bialkin's representation of Ruskin occurred in 1980, 16 years earlier, when he was a member of another law [sic]. Skadden's representation of Ruskin occurred in 1989, at a time when it was not representing UM&M, on matters having nothing to do with the bankruptcy. These were not matters of great moment, and at the conclusion of the evidentiary hearing, the assistant U.S. Trustee stated his belief that the belated disclosure "was nothing more than an oversight." (A. 618). (fn: Reference to "A." are to appendix to the brief submitted by Skadden.)

Judge Gonzalez presided over the bankruptcy proceedings for more than a year and a half. He was familiar with the quality of Skadden's work. He heard the testimony of the witnesses, including the Skadden partners, and he was in the best position to evaluate their explanations. The $225,000 reduction represented a 16% reduction of Skadden's total fee application and a 50% reduction of its fees for the period prior to the late disclosure. Judge Gonzalez acted well within his discretion in granting Skadden's application for fees with a $225,000 reduction for the late disclosure. Accordingly, the Bankruptcy Court's decision in this respect is affirmed.

2. ZR&G's Fee Award

I have considered Feldman's arguments with respect to the Bankruptcy Court's award of fees to ZR&G. The arguments are meritless. Accordingly, the Bankruptcy Court's award of fees to ZR&G is affirmed.

3. The Denial of Feldman's Application for Compensation

In the Bankruptcy Court, Feldman applied pursuant to 11 U.S.C. § 503 (b) for $349,575 in fees and $1,235 in costs. He sought compensation for 480 hours, at an hourly rate of $450, with a contingency bonus of 50%. He also sought compensation for two other attorneys who assisted him. The Bankruptcy Court conducted a hearing and denied the application on June 10, 1997.

Section 503 (b) (3) (D) permits a court to allow a creditor or stockholder an administrative claim for "actual, necessary expenses...incurred...in making a substantial contribution in a case under chapter 9 or 11 of this title." An applicant for a "substantial contribution" award of compensation must demonstrate that he or she has confer[red] a significant and demonstrable benefit upon the reorganization process." In re Best Prods. Co., 173 B.R. 862, 866 (Bankr. S. D. N.Y. 1994). A substantial contribution award is made only for "extraordinary creditor actions," on "those rare occasions when the creditor's involvement truly fosters and enhances the administration of the estate." Id.

Here, the Bankruptcy Court found not only that Feldman and his colleagues had failed to make "a direct, significant, and substantial benefit to the estate," but that many of Mr. Feldman's efforts...caused an increase in the fees incurred" by the debtors and the Committee. (A.966). The Bankruptcy Court concluded that some of Feldman's efforts were duplicative of the efforts of the Committee and the U.S.

Trustee, and that any benefit his efforts did confer on the estate were not "sufficiently significant" to warrant an award under section 503 (b) (A. 966-67).

The Bankruptcy Court's factual findings were not clearly erroneous; it applied the correct legal standards; and it did not abuse its discretion in concluding that Feldman and his colleagues were not entitled to any compensation. Its decision in this respect is affirmed.

4. The Denial of Feldman's Application for Sanctions

In the Bankruptcy Court, Feldman moved for sanctions against Skadden, three of its partners, and Ruskin. The Bankruptcy Court denied the motions on June 10, 1997.

Feldman's arguments on appeal are completely without merit. The Bankruptcy Court's decision not to impose sanctions was well within its discretion and is therefore affirmed.

CONCLUSION

The Bankruptcy Court's orders are affirmed in all respects, with costs.

SO ORDERED

Dated: New York, New York
January 5, 1999

/s/ DENNY CHIN
United States District Judge

APPENDIX D

[Ruling of Bankruptcy Judge Arthur J. Gonzalez at Hearing Held on June 10, 1997] (pp. 65-73 of Transcript)

THE COURT: That resolves the initial stage of the fees.

Next I will move to the sanctions issue with respect to Skadden, Arps in which the hearing was held a number of months ago. It will take about ten minutes to read into the record. I am going to take a five minute break. Then I will be back.

(Whereupon, at this point in the proceedings there was a recess, after which the proceedings continued as follows:)

THE COURT: After reviewing the pleadings in this matter and having presided over an evidentiary hearing and having heard oral argument in support and opposition to the objections to the fees and expenses sought by Skadden, Arps, Debtor's counsel, the Court finds that relief is plainly warranted for nondisclosure and pursuant to 328 of the Code, which permits the Court to deny fees and reimbursement of expenses of a professional person retained pursuant to Section 327 (a) if at any time during that employment the professional person is not disinterested or holds an adverse interest to the interest of the estate with respect to the matter in which the professional person is employed, The Leslie Fay Companies, Inc., et al., 175 B.R. 575 (1994)

There are two issues that need to be addressed

regarding the retention issue: (1) Skadden's failure to comply with the disclosure requirements set forth in Federal Rule of Bankruptcy Procedure 2014; and (2) whether Skadden was qualified to be retained as Debtor's counsel pursuant to Section 327 (a).

There is no dispute that Skadden failed to comply with the disclosure requirements. Nor is there any dispute that Skadden did not literally meet all the requirements of Section 327 (a).

There is, however, a dispute as to whether Skadden's failure to comply with 327 (a) is limited to the issue of its partner, Kenneth Bialkin's stock ownership in UM&M, which ownership would disqualify Skadden under the definition of disinterestedness in Section 101 (14) (A) or whether such ownership and other contacts between UM&M and Uzi Ruskin, on the one hand, rendered Skadden and Mr. Bialkin, on the other hand, rendered Skadden not qualified under 327 (a) because this relationship resulted in Skadden having an adverse interest, as such as defined in 101 (14) (E) [sic] or in the second prong of 327 (a).

The Court finds that but for Mr. Bialkin's stock ownership in UM&M, Skadden's connections would not have disqualified it from being Debtor's counsel under Section 327 (a).

Had Skadden revealed Mr. Bialkin's stock ownership,

as they had done in the affidavit of disinterestedness filed in 1990 for the filing of UM&M in Delaware, this Court would not have approved the retention until the disabling issue of the stock ownership was resolved by a disposition of the stock and at that point would have approved their retention.

Throughout this case, the Debtor maintained that the UM&M stock was worthless. Nonetheless, ownership of its stock the definition of disinterestedness resulting in an inability to be retained under 327 (a), in the view of this Court.

Having found that Skadden was not disinterested and therefore not qualified to serve as Debtor's counsel during the period of time Mr. Bialkin held the stock of UM&M, the Court must determine what sanction would be appropriate under the circumstances. Sanctions could range from disqualifying Skadden for the entire case, or some portion thereof, or imposing an economic sanction.

Mr. Feldman argues for disqualification and a disallowance of all fees, the United States Trustee does not contend that Skadden would have been rendered not disinterested but for the stock ownership issue, and argues for an economic sanction in the amount of the fees and expenses incurred during the period Skadden was not qualified to be Debtor's counsel. The Committee has not taken a position regarding this issue.

I divert from reading this and ask Committee's counsel that is what my records indicate. Is that accurate?

MR GOTTFRIED: That's accurate, Your Honor.

THE COURT: Thank you.

Based upon the record before me, including the various pleadings and the hearings held in this matter, the Court finds disqualification, either in whole or in part, of Skadden not warranted. However, the Court finds that an economic sanction is warranted.

With respect to the economic sanction, as stated in above, relief is plainly warranted for nondisclosure and pursuant to 328 of the Code, which permits the Court to deny reimbursement of expenses of a professional person at any time during the employment of its professional person is not disinterested or holds an adverse interest to the interest of the estate with respect to the matter in which the professional is employed.

In making my determination as to the appropriate economic sanction I have considered, among other things, the following:

prior to the preparation of Skadden's initial affidavit of disinterestedness, it did not obtain and review a copy of the affidavit of disinterestedness filed in Delaware in

1990 regarding Skadden and its connections with UM&M;

although a comprehensive disclosure questionnaire was sent throughout the firm, Skadden did not sufficiently enforce compliance regarding its prompt return;

failure to follow up on returning of the questionnaire was compounded by the fact that one of the questionnaires that were not returned was Mr. Bialkin's, a partner who had a great deal of contact with the Debtor throughout its relationship with Skadden;

the fact that it took in excess of forty-five days for Mr. Bialkin to dispose of the stock once he became aware of the necessity to do so;

the fact that the senior associate and partner in charge of the bankruptcy matter immediately took steps to make the appropriate disclosure when such matters came to their attention;

although the connections revealed in the various amended affidavits did not result in "an adverse interest" that would warrant disqualification, the delay in the disclosure of those connections prevented the parties in interest and the Court from making an informed review of the retention application at the outset of the case;

the fact that five affidavits were filed in this case,

where had proper procedures been followed and enforced, the initial affidavit would have contained all relevant information;

the amount of fees sought by Skadden is $1,409,259.80 and expenses of $130,968.63;

the approximate amount of fees incurred during the period during which Skadden was disqualified to serve as counsel to the Debtor was $750,000 and expenses of $75,000;

the approximate amount of fees incurred prior to the disclosure of Mr. Bialkin's stock ownership was $425,000 and expenses of $50,000.

Just to put those two comments in perspective. The total fees during the period in which Skadden was not disinterested pursuant to the disinterested definition of 101 (14) (A) was $725,000. Within that period approximately $425,000 was incurred prior to the disclosure of Mr. Bialkin's stock ownership. So the total number of that period is $725,000. The portion of that period in which there was no disclosure was fees incurred during that portion of $425,000.

The fees incurred by the Committee regarding the disinterestedness issue; and

the importance of disclosure of the disclosure process to the integrity of the system and the need for vigilant enforcement.

Therefore, based on the foregoing, the Court finds that an economic sanction is appropriate, and based upon the

aforementioned considerations the amount of the sanction is $225,000, which will be used as a figure to reduce the amount awarded Skadden, Arps as previously found by this Court,

Skadden can settle an Order regarding the entire fee issue, the awards and the amount of the sanctions, and submit that to the Court.

I believe that resolves all issues before me today.

APPENDIX E

§ 327 (a) of the Bankruptcy Code (11 U.S.C. §327 (a))

§327. Employment of professional persons

(a) Except as otherwise provided in this section, the trustee, with the court's approval, may employ one or more attorneys, accountants, appraisers, auctioneers, or other professional persons, that do not hold or represent an interest adverse to the estate, and that are disinterested persons, to represent or assist the trustee in carrying out the trustee's duties under this title.

APPENDIX F

§503 (b) (3) (D) and (4) of the Bankruptcy Code
(11 U.S.C. §503 (b) (3) (D) and (4))

§ 503. Allowance of administrative expenses

(b) After notice and a hearing, there shall be allowed administrative expenses, other than claims allowed under section 502(f) of this title, including--

****

(3) the actual, necessary expenses, other than compensation and reimbursement specified in paragraph (4) of this subsection, incurred by---

****

(D) a creditor, an indenture trustee, an equity security holder, or a committee representing creditors or equity security holders other than a committee appointed under section 1102 of this title, in making a substantial contribution in a case under chapter 9 or 11 of this title; or

(4) reasonable compensation for professional services rendered by an attorney or an accountant of an entity whose expense is allowable under paragraph (3) of this subsection, based on the time, the nature, the extent, and the value of such services, and the cost of comparable services other than in a case under this title, and reimbursement for actual, necessary expenses incurred by such attorney or accountant;

APPENDIX G

Bankruptcy Rule 2014 (a)

(a) Application for an Order of Employment. An order approving the employment of attorneys, accountants, appraisers, agents, or other professionals pursuant to § 327, § 1103, or § 1114 of the Code shall be made only on application of the trustee or committee. The application shall be filed and, unless the case is a chapter 9 municipality case, a copy of the application shall be transmitted by the applicant to the United States trustee. The application shall state the specific facts showing the necessity for the employment, the name of the person to be employed, the reasons for the selection, the professional services to be rendered, any proposed arrangement for compensation, and, to best of the applicant's knowledge, all of the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee. The application shall be accompanied by a verified statement of the person to be employed setting forth the person's connections with the debtor, creditors, any other party in interest, their respective attorneys and accountants, the United States trustee, or any person employed in the office of the United States trustee.

APPENDIX H

28 U.S.C. §1408

§ 1408. Venue of cases under Title 11

Except as provided in section 1410 of this title, a case under title 11 may be commenced in the district court for the district--

(1) in which the domicile, residence, principal place of business in the United States, or principal assets in the United States, of the person or entity that is the subject of such case have been located for the one hundred and eighty days immediately preceding such commencement, or for a longer portion of such one-hundred-and-eighty-day period than the domicile, residence, or principal place of business, in the United States or principal assets in the United States, of such person were located in any other district; or

(2) in which there is pending a case under title 11 concerning such person's affiliate, general partner, or partnership.